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OPINIONS BELOW

The opinion of the District Court in *United States* v. *Hine Pontiac* (*Hine Pontiac*, R. 85–86) is not officially reported. The opinion of the District Court in *United States* v. *Modern Olds, Inc.* (*Modern Olds*, R. 63–65) is not officially reported. The findings of fact and opinion of the Tax Court in *Commissioner* v. *Kilborn* (*Kilborn*, R. 24–25) are reported at 29 T. C. 102. The Court of Appeals did not write an opinion in any of the three cases.[2]

JURISDICTION

The judgment of the Court of Appeals in *United States* v. *Hine Pontiac* was entered on September 6, 1958 (Appendix A, *infra*, pp. 9–10); its judgment in *United States* v. *Modern Olds, Inc.* was entered on September 15, 1958 (Appendix A, *infra*, pp. 11–12); and its judgment in *Commissioner* v. *Kilborn* was entered on September 30, 1958 (Appendix A, *infra*, pp. 13–14). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether an accrual-basis taxpayer who sells property and receives part of his gain on the sale in cash and part in the form of a credit—the latter portion to be ultimately satisfied either by payment in cash or by offset against the taxpayer's obligations—is required to report the amount of gain so credited

[2] In all three cases, pursuant to stipulations, judgments were entered by the court below in conformity with its decisions in *Texas Trailercoach, Inc.* v. *Commissioner*, 251 F. 2d 395, and *West Pontiac, Inc.* v. *Commissioner*, 257 F. 2d 810.

as well as the gain in cash) as income for the year in which the credit is made.[3]

STATUTES AND REGULATION INVOLVED

The statutory provisions involved are Sections 22 (a), 41 and 42 of the Internal Revenue Code of 1939. Those sections, together with Rev. Rul. 57–2, 1957–1 Cum. Bull. 17, are set forth in Appendix B, *infra*, pp. 15–19.

STATEMENT

Hine Pontiac:

During the taxable years 1953 and 1954, Hine Pontiac, an accrual-basis taxpayer, was engaged in the business of selling new and used automobiles. It sold cars on credit, with a bank or finance company agreeing to accept the note of the purchaser for the unpaid balance of the purchase price plus finance charges. Under a separate contract between the dealer and the finance company, the notes were accepted, without recourse, and the finance company remitted to the taxpayer the unpaid portion of the selling price of the automobile. (*Hine Pontiac*, R. 26, Exs. 3–6, R. 29, 31–58.)

Under the agreement between taxpayer and the finance company, the notes were acquired by the finance company at a specified rate of discount. To the extent that the interest and finance or service charges included in the notes exceeded the specified rate of discount in the contract, the finance company recorded a credit to a so-called dealer's reserve account,

[3] Other issues raised by the pleadings were not reached by the courts below.

the credit being made immediately upon the assignment of the note. Any losses sustained by the finance company arising from the failure of the security to be sufficient to satisfy the balance due on the note and other specified losses were chargeable against the dealer's reserve account. When the amount in this account exceeded a specified minimum on agreed settlement dates, the finance company was obligated to pay such excess to the taxpayer. (*Hine Pontiac,* R. 26–28.)

The following amounts reflected in the dealer's reserve accounts at the end of the indicated years were not reported as income: 1953—$30,822.18; 1954—$58,154.69. The Commissioner determined deficiencies of $16,027.54 for 1953 and $26,381.47 for 1954 by including the aforementioned amounts in income in the respective years in which they were credited to the dealer's reserve account. (*Hine Pontiac,* R. 24, 28–29.) Hine Pontiac paid these deficiencies, plus interest of $5,581.91, and then filed claims for refund for the years 1953 and 1954; the claims were denied, and suit for refund followed. (*Hine Pontiac,* R. 25.) The District Court overruled the Commissioner's determination and entered judgment for Hine Pontiac in the principal amount of $42,409.01, plus interest. (*Hine Pontiac,* R. 87–89.) The Court of Appeals affirmed. (Appendix A, *infra,* pp. 9–10.)

Modern Olds, Inc.:

For the fiscal year ended March 31, 1954, Modern Olds was engaged in the business of selling automobiles. It sold cars on credit, receiving notes and chattel mortgages secured by a chattel mortgage lien for

the unpaid balance due on the purchase price, plus insurance premiums, interest and finance charges. Pursuant to a written contract with the Commercial Credit Corporation, a finance company, the taxpayer in the taxable year sold and transferred the greater portion of the notes to that company, endorsed without recourse. (*Modern Olds,* R. 17, 26–30, Ex. 2, R. 26–31, 37.)

On transfer and delivery of the notes, the finance company paid the taxpayer the unpaid balance of the cash selling price, but none of the interest or carrying charges which were included on the face of the note. At the time of such sale an additional amount was credited to the dealer's reserve account in taxpayer's name. Under its agreement with the finance company, the taxpayer was obligated to repurchase repossessed cars for the unpaid balance due on the notes, if repossessed within 90 days, or at the appraised value of the cars if repossessed at a later date. (*Modern Olds,* R. 18, 27–28.)

The finance company could charge against the reserve any indebtedness of the taxpayer to it, and was obligated to pay the taxpayer 3 times a year, if taxpayer was not then indebted to it, amounts by which the reserve exceeded 3% of the total balances outstanding on all notes purchased. The amount of $13,953.72, representing 3% of the customers' notes outstanding, was reflected in the dealer's reserve account at the end of the taxable year and was not reported as income, although the taxpayer is on the accrual basis. The Commissioner determined a deficiency of $4,186.11 by including the aforementioned

amount in income for the fiscal year ended March 31, 1954, the period in which the amount was credited to the dealer's reserve account. Modern Olds paid the deficiency, plus interest of $283.11, and then filed a claim for refund; the claim was disallowed, and this suit for refund followed. (*Modern Olds,* R. 14–16, 27.) The District Court overruled the Commissioner's determination and entered judgment for Modern Olds in the principal amount of $4,186.11, plus interest. (*Modern Olds,* R. 65–66.) The Court of Appeals affirmed. (Appendix A, *infra,* pp. 11–12.)

Charles M. Kilborn:

During the taxable years 1947–1949, a partnership of which Kilborn was a member, known as the Y Auto Sales, engaged in the business of selling used automobiles. The partnership sold cars on credit, receiving notes of purchasers for the balance due on the unpaid purchase price. Pursuant to written contract with the First National Bank of Mobile, the partnership sold and transferred the notes to that bank, with full recourse, and received the face amount of the notes, less the bank's discount, the amount required for recording the paper and the gross premiums on the insurance the bank was to take out. Of this purchase price, the bank paid or credited to the unrestricted use of the partnership the unpaid balance of the price for which the car was sold, less any financing charges or other charges imposed on the balance, or the National Automobile Dealers' Association's average loan value, whichever was lower. Any balance remaining of the purchase price of the notes was credited to a special reserve account in the name of

the partnership which by agreement was pledged by the partnership to the bank as collateral security for the payment by it of any sums which it might then or thereafter owe to the bank. (*Kilborn*, R. 26–34.)

Although it was on the accrual basis, the following amounts representing annual increments to the specific reserve account in the years indicated were not reported by the partnership as income: 1947—$3,837.29; 1948—$14,819.88; 1949—$1,691.43. The Commissioner determined deficiencies against the taxpayers by including the aforementioned amounts in income of the partnership for the respective years in which they were credited to the reserve account.[4] (*Kilborn*, R. 36, 159–175.) The Tax Court sustained the deficiencies. (*Kilborn*, R. 46.) The Court of Appeals reversed. (Appendix A, *infra*, pp. 13–14.)

REASONS FOR GRANTING THE WRIT

The question in these cases is the same as that presented in *Commissioner* v. *John R. Hansen and Shirley G. Hansen*, No. 380, this Term, and in *Commissioner* v. *Burl P. Glover*, No. 381, this Term, in which petitions for writs of certiorari were granted on November 10, 1958.

The agreements between the taxpayer automobile dealers and the financing companies with which they dealt are the same in all substantial respects as the agreement involved in the above cases. As in those cases, the decisions below are in direct conflict with

[4] The deficiencies on this and other issues, not here involved, aggregated $5,454.05, plus penalties of $1,209.43. (*Kilborn*, R. 46.)

decisions of the Sixth and Seventh Circuits.[5] See *Schaeffer* v. *Commissioner*, 258 F. 2d 861 (C. A. 6th), petition for rehearing pending; and *Baird* v. *Commissioner*, 256 F. 2d 918 (C. A. 7th), petition for certiorari pending, both of which are reprinted in Appendix C to the Commissioner's petition in *Hansen*. Writs having been granted in *Hansen* and *Glover*, this Court will soon have occasion to decide the issue involved in the instant cases. We therefore believe it appropriate, in order to protect the Government's interests, to file a petition in these cases. The Court may wish to hold this petition in abeyance pending disposition on the merits in Nos. 380 and 381.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

JOSEPH F. GOETTEN,
CAROLYN R. JUST,
Attorneys.

DECEMBER 1958.

---

[5] As we noted in our petition in *Hansen*, the Tax Court has regularly sustained the Commissioner's position over a period of seventeen years. The Fourth and Fifth Circuits, as well as the Eighth and Ninth, have ruled to the contrary.

APPENDIX A

In the United States Court of Appeals for the Fifth Circuit

No. 17,242

UNITED STATES OF AMERICA, APPELLANT

v.

HINE PONTIAC, APPELLEE

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

Judgment

(Entered September 6, 1958)

Before HUTCHESON, JONES and WISDOM, Circuit Judges

On stipulation of the parties to this proceeding, by their counsel of record, it appearing that one of the issues in this case is in certain respects the same as that decided by this Court on January 7, 1958, in *Texas Trailercoach, Inc.* v. *Commissioner,* 251 F. 2d 395, and on February 6, 1958, in *West Pontiac, Inc.* v. *Commissioner*; and

It further appearing that the parties to this proceeding desire to avoid further expense in connection with the appeal; and that the appellant is willing, without conceding the correctness of the appellee's position, that the case be disposed of without briefing and oral argument;

Now therefore, it is ordered adjudged and decreed

that the decision of the District Court filed in this cause on December 18, 1957, is hereby affirmed in accordance with this Court's opinions in *Texas Trailercoach, Inc.* v. *Commissioner* and *West Pontiac, Inc.* v. *Commissioner.*

(S) JOHN MINOR WISDOM,
U. S. Circuit Judge—for the Court.

A true copy.
Test:

EDWARD W. WADSWORTH,
Clerk, U. S. Court of Appeals, Fifth Circuit.
By (S) GILBERT F. GANUSHEAN,
Deputy,
New Orleans, Louisiana.

Dated: September 6, 1958.
Consented to as to Form:

(S) Charles K. Rice,
CHARLES K. RICE,
Attorney for Appellant,

(S) L. W. Anderson,
L. W. ANDERSON,
1201 Corrigan Tower, Dallas 1, Texas,
Attorney for Appellee.

In the United States Court of Appeals for the Fifth Circuit

No. 17,245

UNITED STATES OF AMERICA, APPELLANT

v.

MODERN OLDS, INC., APPELLEE

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

Judgment

(Entered September 15, 1958)

Before HUTCHESON, Chief Judge, and JONES and WISDOM, Circuit Judges

On stipulation of the parties to this proceeding, by their counsel of record, it appearing that one (1) issue in this case is essentially the same as that decided by this Court on January 7, 1958, in *Texas Trailercoach, Inc.* vs. *Commissioner,* 251 F. 2d 395, and on February 6, 1958, in *West Pontiac, Inc.* vs. *Commissioner;* and

It further appearing that the parties to this proceeding desire to avoid further expense in connection with the appeal; and that the appellant is willing, without conceding the correctness of the appellee's position, that the case be disposed of without briefing and oral argument;

It further appearing that there are additional issues as to whether the amounts credited to a reserve account are income (1) irrespective of the specific provisions of the written reserve agreement between taxpayer and Commercial Credit Company (which issue is germane to the theory of the above cited decisions)

and (2) irrespective of the evidence in the record with respect to said amount of reserves being unaccrued and unpaid interest, which last issue it is unnecessary for this Court to reach at this time;

Now, therefore, it is ordered, adjudged and decreed that the Judgment of the District Court filed in this case on December 17, 1957, is hereby affirmed in accordance with this Court's opinions in *Texas Trailcoach, Inc.* vs. *Commissioner,* and *West Pontiac, Inc.* vs. *Commissioner.*

(S) JOHN MINOR WISDOM,
Judge.

Dated: September 15, 1958.

Consented to as to form:

(S) Charles K. Rice,
CHARLES K. RICE,
Attorney for Appellant,

(S) HERBERT S. BONNEY,
(Signed on carbon copy)
BONNEY, WADE AND STUBBLEFIELD,
Attorney for Appellee,
Dallas, Texas.

In the United States Court of Appeals for the Fifth Circuit

No. 17,226

CHARLES M. KILBORN AND ANGELINE W. KILBORN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Judgment

(Entered September 30, 1958)

Before RIVES, BROWN and WISDOM, Circuit Judges

On stipulation of the parties to this proceeding, by their counsel of record, it appearing that the dealer reserve issue in this case is essentially the same as that decided by this Court on January 7, 1958, in *Texas Trailercoach, Inc.* v. *Commissioner,* 251 F. 2d 395, and on February 6, 1958, in *West Pontiac, Inc.* v. *Commissioner;* and it appearing that the double penalty issue in this case is essentially the same as that decided by this Court on July 23, 1958, in *Patchen* v. *Commissioner;* and

It further appearing that the parties to this proceeding desire to avoid expense in connection with this appeal; and that the respondent is willing without conceding the correctness of the petitioner's position on the dealer reserve issue, and that the petitioners are willing without conceding the correctness of the respondent's position on the double penalty issue, that these issues be disposed of without briefing and oral argument, and that all other issues raised on appeal be deemed to have been abandoned;

Now therefore, it is ordered, adjudged and decreed that the decision of the Tax Court entered in this cause on January 31, 1958—all issues raised on appeal other than the dealer reserve and double penalty issues having been abandoned—is hereby reversed insofar as the dealer reserve issue is concerned, in accordance with this Court's opinions in *Texas Trailercoach, Inc.* v. *Commissioner, West Pontiac, Inc.* v. *Commissioner,* and is, in all other respects, affirmed, in accordance with the Court's opinion in *Patchen* v. *Commissioner.*

(Signed) RICHARD T. RIVES,
Judge.

Dated: Sept. 29, 1958.

Consented to as to form:

(S) Vincent F. Kilborn
VINCENT F. KILBORN, Esquire
First National Bank Building, Mobile, Alabama
Attorney for Petitioners.

By: (S) VINCENT F. KILBORN
(S) Charles K. Rice
CHARLES K. RICE
Assistant Attorney General,
Attorney for Respondent.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 42.)

Rev. Rul. 57-2, 1957-1 Cum. Bull. 17:

Amounts withheld by banks or finance companies to cover possible losses on notes purchased from dealers constitute income to dealers employing the accrual method of accounting, to the extent of their interest therein at the time the amounts are recorded on the books of the bank or finance company as a liability to the dealer, regardless of whether charges for worthless notes are also made to the account pursuant to an agreement between the parties. Losses sustained on worthless notes shall be separately established by the dealer as required by section 166 of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to state its position with respect to the treatment, for Federal income tax purposes, of amounts withheld by banks and finance companies to cover possible losses on notes purchased from automobile or other dealers employing the accrual method of accounting, and which are recorded on the books of the bank or finance company as a liability of the bank or finance company to the dealer.

The steps generally involved in transactions concerning automobile dealers are as follows: When a car is purchased on credit from a dealer, the purchaser makes a down-payment,

either in the form of cash or by turning in another car at an agreed value, the balance being satisfied by the purchaser's promissory note and a supporting conditional sales contract. The face amount of the note reflects two elements—the balance of what would be the purchase price of the car, if bought for cash, and a finance charge. As between the purchaser and the dealer, the transaction is closed and completed at this point with the attendant tax consequences to the dealer.

It is then common practice for the dealer to sell or discount the purchaser's note and sales contract to some financial institution. The finance company or bank acquires the note at a value somewhat less than its face value, the difference representing a charge for its service. Simultaneously, either cash or unrestricted credit is given to the dealer to the extent of the amount reflected in the face value of the note that corresponds to the unpaid balance of the cash retail price of the car. The difference between the face value of the note and the sum of the finance company's charge and its credit or immediate payment to the dealer (representing part of the finance charge previously mentioned) is then credited on the books of the finance company as a liability of the finance company to the dealer. The accumulation of these credits is generally known as a "dealers reserve" and is the specific object of the present consideration.

Settlement of the liability represented by the reserve is subject to agreement between the particular dealer and the financial institution involved. In some instances, the agreement does not contemplate the charging of any items against the reserve account, while in others the account reflects a running record of various transactions between the parties, that is, both credits and charges are entered, depending upon the nature of the item. Thus, in certain in-

stances, the dealer and the finance company may agree that notes purchased or discounted are to be charged to the reserve account in the event they become worthless.

With regard to those instances where losses incurred by a finance company on notes purchased from automobile dealers may not be charged against the reserve, the credits to the reserve, by the finance company in favor of a dealer who employs the accrual method of accounting constitute income to the dealer at the time such credit is made, even though the dealer is not immediately or even currently able to draw on the entire reserve. See G. C. M. 9571, C. B. X–2, 153 (1931), and *Shoemaker-Nash, Inc.* v. *Commissioner,* 41 B. T. A. 417. The principles involved in the purchase of notes from automobile dealers by banks or finance companies as described above are equally applicable where notes are purchased, under similar conditions, from dealers in items other than automobiles.

Where a dealer's reserve is in the nature of a running account, the charging thereto of worthless notes pursuant to agreement between the parties has no bearing upon the fact that taxable income has been received by the dealer, or upon the time of its realization as otherwise evidenced by the credits to such reserve.

Accordingly, it is held that credits to such reserve, in the case of a dealer employing the accrual method of accounting, constitute income to the dealer at the time such credits are made regardless of whether charges to the account for worthless notes are also made pursuant to an agreement between the parties. Losses sustained on worthless notes are to be separately established by the dealer as required by the provisions of section 166 of the Internal Revenue Code of 1954 relating to bad debts.

In arriving at these conclusions, consideration has been given the case of *Blaine Johnson et al.* v. *United States,* 233 Fed. (2d) 952. See also, *Albert M. Brodsky et ux.* v. *Commissioner,* 27 T. C. No. 23.

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FILED
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JAMES R. BROWNING, Clerk

No. 561

In the Supreme Court of the United States

OCTOBER TERM, 1958

COMMISSIONER OF INTERNAL REVENUE, Petitioner

vs.

CHARLES M. KILBORN AND ANGELINE W. KILBORN

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

MICHAEL J. SALMON, Esq.
VINCENT F. KILBORN, Esq.
Counsel for Respondents
307 First National Bank Building
Mobile, Alabama

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. .....

COMMISSIONER OF INTERNAL REVENUE, Petitioner

vs.

CHARLES M. KILBORN AND ANGELINE W. KILBORN

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

OPINIONS BELOW

The findings of fact and the opinion of the Tax Court in *Commissioner vs. Kilborn* are reported at 29 T. C. 102. The United States Court of Appeals for the Fifth Circuit reversed the Tax Court in ..... F (2d) ..... (5 Cir. 1958).

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

QUESTION PRESENTED

The question as posed by the Petition for Certiorari is not the question presented by the record in *Charles M. Kilborn.* The precise question presented by the record in *Charles M. Kilborn* may be stated as follows:

> "Whether sums credited by a bank to a special reserve account pledged irrevocably to secure all sums owing by all customers of an automobile dealer on any of the conditional sale contracts discounted by the dealer with the bank, under arrangements calling for full recourse on the dealer as to all sums owing under the aggregate

of all contracts discounted, constitutes income of the dealer in the year credited or in the year paid the dealer by the bank, where any payment from the reserve account to the dealer at any time rested entirely in the discretion of the bank."

STATUTES AND REGULATION INVOLVED

The statutes and regulation are adequately set forth in the Petition at Appendix B.

STATEMENT

The Government's statement of the fact situation in *Charles M. Kilborn* (Page 6, Application for Certiorari) is inadequate, inaccurate and misleading as a presentation of the facts established by the record.

Specifically the portion of the Government's statement with regard to *Kilborn* to which exception is taken is as follows (Petition, Page 6):

> "The partnership sold cars on credit, receiving notes of purchasers for the balance due on the unpaid purchase price. Pursuant to written contract with the First National Bank of Mobile, the partnership sold and transferred the notes to that bank, with full recourse, and received the face amount of the notes, less the bank's discount, the amount required for recording the paper and the gross premiums on the insurance the bank was to take out. Of this purchase price, the bank paid or credited to the unrestricted use of the partnership the unpaid balance of the price for which the car was sold, less any financing charges or other charges imposed on the balance, or the National Automobile Dealers' Association's average loan value, whichever was lower. Any balance remaining of

the purchase price of the notes was credited to a special reserve account in the name of the partnership which by agreement was pledged by the partnership to the bank as collateral security for the payment by it of any sums which it might then or thereafter owe to the bank."

The correct fact picture from the Record (pages 26-35) is:

Kilborn was a member of a partnership selling used automobiles (Record, Pages 56 and 57). The partnership reported on a *cash* basis although the Tax Court in its opinion below held that the partnership was not on a cash basis because an inventory of automobiles was used; hence it said no other method than accrual would properly reflect income (not conceded by Kilborn to be sound reasoning for putting all of its methods of bookkeeping on a purely accrual basis) (Record, Page 39).

The partnership depended upon the local bank to finance time payment sales of automobiles at retail to customers. To finance these time sales the bank and the partnership entered an agreement covering the financing by the bank of time payment sales. By the contract, when the dealer sold a car on time the dealer added to the unpaid balance of cash selling price remaining after credit for the down payment, a sum equal to the amount necessary to record the paper, the gross premiums on insurance to be charged and an amount not greater than the rate in a specified chart to represent finance or carrying charges. The total of the unpaid balance of cash selling price plus these charges, (representing the total time payment balance arrived at) was to be made payable in installments by the buyer. The transaction was to be evidenced by a conditional sale contract retaining title in the dealer until the time bal-

ance of purchase money unpaid was paid by the customer in full.

Under this master financing contract between the dealer and the bank the dealer presented the retail conditional sale contracts to the bank with *full recourse* on the dealer. This paper was then discounted by the bank at the rate of one-half of one per cent per month computed on the actual unpaid balance of the *cash* selling price plus premiums for insurance plus recording fees, (i.e. excluding in the computation a discount on the amount included in the time purchase balance for "finance charges"). The dealer was then advanced by the bank for the dealer's unrestricted use the amount representing the unpaid *cash* for which the car was sold without inclusion of financing or other charges imposed on the buyer (subject to limitations that the amount advanced the dealer should not exceed the loan value of the car sold according to a standard average loan valuation table). After the bank paid costs of recording the contract, gross premiums for insurance on the automobile and had made the payment of unpaid cash selling price to the dealer the remaining amount (the difference between the face value of the total indebtedness evidenced by the contract and the total amounts actually disbursed by the bank) was credited to a special "dealer reserve" account in the dealer's name on the books of the bank. This credit stood forthwith pledged to the bank as collateral security to secure all sums owing by *that* and *any other* customer of the dealer owing under any automobile sales contract financed for dealer through the bank or any other sums which dealer owed bank by virtue of dealer's recourse endorsement of the various contracts financed or which the dealer might otherwise owe the bank under the financing agreement between the dealer and the bank.

Under the contract, when the title of a conditional sale contract had been transferred to the bank, the bank devoted reasonable efforts to collect amounts becoming due from the customers. If two payments from the customers became delinquent the dealer was required by his contract for *full recourse* on the dealer to repurchase the contract forthwith. Repurchase was to be made by the dealer from *other* funds for the *face amount remaining unpaid* less "unearned discount" which "unearned discount" was credited against the unpaid balance first; the remaining repurchase price the dealer was required to pay from the dealer's funds. If the dealer failed on demand to buy back the contract the bank *could charge* the entire purchase price back against the amount in the dealer reserve account and effectuate a retransfer of the contract to dealer in that manner. So long as any indebtedness was owing on any one or all of the total number of contracts financed by the bank, the dealer had *no right* to demand or receive *any* portion of the reserve account.

No part of the amount credited to the dealer reserve accounts was reported by the dealer as income in the year when credited to the *special reserve* account. No repurchase of a defaulted contract by the dealer was charged by the bank against the reserve account in any year. In 1949 when the bank considered the reserve account sufficiently large for collateral security purposes, but without contractual obligation to do so, it released and paid the dealer in one sum, a part of the total credited to the reserve account. ($5,000.00) This sum, when paid by the bank to the dealer, was reported as income when actually received (in 1949).

Whether the amounts credited to the reserve account were taxable to the dealer when credited or taxable only when actually paid the dealer, is the point in dispute.

The taxpayer insists the credits did not constitute income when credited but were sums contingent and uncertain and incapable of ascertainment that taxpayer might ever receive them. Hence these credits to the reserve account are not income until received by the bank's voluntary payment of funds to the dealer, whether the dealer be on a cash basis, accrual basis or some hybrid of the two.

REASONS FOR DENYING THE WRIT

Kilborn presents no novel question. Any seemingly conflicting result of decisions in various circuits arises from a different fact situation or conflicting applications of principles long stated by this Court rather than a disagreement as to principles involved.

In *Spring City Foundry Company vs. Commissioner*, 292 U.S. 182, 184, 185, 54 Sup. Ct. 644 (1933) the Court stated the principle:

> "Keeping accounts and making returns on the accrual basis as distinguished from the cash basis, imports that it is the *right* to receive, and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues."

In *North American Oil Consolidated vs. Burnet*, 286 U.S. 417, 423, 52 Sup. Ct. 613 (1931) the holding was:

> "For the company was not required in 1916 to report as income an amount which it might never receive. (cases omitted) There was no constructive receipt of the profits in that year because at no time during the year was there

a right in the company to demand that the receiver pay over the money. Throughout 1916 it was uncertain who would be declared entitled to the profits. It was not until 1917 when the District Court entered a final decree vacating the receivership and dismissing the bill that the company became entitled to receive the money. Nor is it material, for the purposes of this case, whether the company's return was filed on the cash receipts and disbursement basis, or on the accrual basis. In neither event was it taxable in 1916 on account of income which it had not yet received and which it might never receive."

That these principles were well understood and applied to financing arrangements essentially the same as *Kilborn* was evidenced by *Keasbey & Mattison Co. vs. United States*, 141 F (2d) 163 (3rd Circuit) as far back as 1944:

"It is the right to receive and not the 'actual receipt' of an amount which determines its accruability. But the right to receive must have become fixed before the right can be said to accrue."

Later in the opinion that Court observed:

"Whether the plaintiff would ever acquire a fixed right to receive anything from the reserve fund was contingent and unascertainable throughout the tax year."

In *Kilborn* the events which create the dealer's liability to the bank under its full recourse agreement by its master finance contract, viz: the execution of the master contract and incident of sales under that contract with full recourse, arise at the same instant the Commissioner would "accrue income" as a result of the transaction.

The companion cases in the Government's petition differ in some respects from the *Kilborn case, supra.* In *United States vs. Hines Pontiac,* F (2d) (5 Cir. 1958) and *United States vs. Modern Oldsmobile, Inc.,* F (2d) (5 Cir. 1958), the agreements between the dealer and the financial institution permitted the financial institution to remit amounts in excess of a certain percentage of the outstanding receivables. Also, the agreements carried only partial recourse provisions. As can be seen in these latter types of arrangements, prevalent in the above cases, the finance company used the reserve as its only buffer against future losses because of their non-recourse nature.

In *Kilborn, supra,* the reserve account was subject to the following contingencies:

1. The Taxpayer could only receive the amounts in the reserve account after all liabilities as a result of all transactions thereunder had been satisfied.

2. The conditional sale contracts were always with full recourse on the dealer.

3. There was never any arrangement for the Taxpayer to demand any amounts of the reserve irrespective of the amounts of the outstanding receivables so long as any sums owing the bank under the contract remained unpaid.

It would appear that the granting of certiorari in this case would only further add to that long line of cases decided by this Court concerning the question of when income accrues.

This conclusion is further buttressed by the decision of *Texas Trailer Coach vs. the Commissioner,* 251 F (2d) 395, 403, 405, (5 Cir. 1958), which held as follows:

> "The closer a tax comes to giving effect to the economic realities, the more bearable it is as the price of national

security and of civilization. The real trouble in this case is that the taxpayer is asked to pay a tax on money he did not in fact receive and had no right to receive during the taxable year in question. He may never receive it, but he is asked to deplete his cash in order to pay it. If compelled to pay, the more business he does—the worse off his cash position will be. But, if a more realistic view is taken, the Government will not be deprived of any tax because when the contingent credit materializes as a fixed, ascertainable claim or if payments are received from the reserve account, the taxpayer must then include the fixed claim or payments in his taxable income."

and further—

"The dealer does not have a fixed, ascertainable claim to the reserve at the time of the sale or holdback; he has a claim for some time in the future—provided the aggregate of the amounts in the account exceed fifteen per cent on the balance due on all contracts. The account may never exceed fifteen per cent. In this case the dealer waited three years to receive any payments from the reserve account. Thus, the dealer's rights to receive payments from a particular sale to a trailer purchaser depends upon not only that purchaser not defaulting but upon other purchasers not defaulting. It depends ultimately, upon the level of the taxpayer's business, and perhaps the level of business generally, (1) being sufficiently high for the reserves to build up to more than fifteen per cent of the unpaid balance on all trailer contracts and, thereafter (2) not declining sufficiently for the defaults of all trailer purchasers to cut into the reserve so as to reduce the account

below fifteen per cent of the unpaid balance due on all contracts."

The Government suggests that the Court may wish to hold its petition for certiorari in *Kilborn* and the companion cases pending decision by the Court in *Commissioner vs. John R. Hansen and Shirley G. Hansen*, No. 380, this Term and *Commissioner vs. Burl P. Glover*, No. 381, this Term. We would prefer that the Court either grant or deny certiorari in order that, if granted, we may be heard on the issues before the Court.

We respectfully ask that certiorari be denied.

Respectfully submitted,

MICHAEL J. SALMON
Counsel for Respondents

VINCENT F. KILBORN
Counsel for Respondents

307 First National Bank Building
Mobile, Alabama

December, 1958

FILE COPY

Office Supreme Court, U.S.
FILED
JAN 5 1959
JAMES R. BROWNING, Clerk

No. 561

In the

Supreme Court of the United States

OCTOBER TERM, 1958

UNITED STATES OF AMERICA,

Petitioner,

v.

HINE PONTIAC,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

PAUL J. SEDGWICK,
Barr Building,
910 Seventeenth Street, N.W.,
Washington, D. C.,
Attorney of Record for Respondent.

L. W. ANDERSON,
1201 Corrigan Tower,
Dallas, Texas.

WARLICK LAW, INC.—1207 HORD STREET—DALLAS—RI 1-6711

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OPINION BELOW

The opinion of the United States District Court in UNITED STATES v. HINE PONTIAC is not officially reported, but is unofficially reported in C. C. H. Paragraph 9210 and 1 A. F. T. F. 2d 58-734.

JURISDICTION

Jurisdiction is sought under provisions of 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

Whether the amounts which certain finance companies credited to a dealer's reserve account in taxpayer's name should be taken into taxpayer's income when so credited where taxpayer was on an accrual basis of accounting; and in the alternative, whether or not the amount retained in such reserve account constitutes a reasonable reserve for bad debts. (See Stipulation filed in the United States Court of Appeals for the Fifth Circuit, Appendix A.)

STATEMENT OF CASE

This is a suit by Hine Pontiac, a corporation, to recover taxes paid upon a deficiency assessed against it for alleged income arising out of dealer's reserves during the taxable years 1953 and 1954. In connection with the operation of its business, Hine Pontiac sold both new and used automobiles on time payment or installment plan of purchase. After the purchase price of the automobile has been agreed upon by Hine Pontiac and the purchaser, the sale is not concluded *unless* and *until* a finance company agrees to accept the note of the purchaser for the balance of the purchase price plus finance charges (Stipulation 13 R. 26). Certain portions of the finance charges are set up in a special account called "dealer's reserve account." This credit to Hine Pontiac by the finance company on the "dealer's reserve account" is made immediately upon the assignment of the note even though the proceeds from said notes have not been collected and will not be collected for

an average period of two years and until the purchaser of the automobile pays the note in full (Stipulation 13 R. 26-27). Hine Pontiac is not entitled to any payments or to use any funds from this account except to the extent that it exceeds a stated percentage of the unpaid balances of notes acquired from Hine Pontiac on the settlement dates called for by the respective contracts. Thus the finance company admits no liability to Hine Pontiac until the "dealer's reserve account" reaches a specified relation to the unpaid balance of notes acquired from Hine Pontiac and then only with respect to the amount by which the "dealer's reserve account" exceeds this minimum on the agreed settlement dates (Stipulation 13 R. 27). The deficiency, therefore, was assessed against the "dealer's reserve account" to which the finance company admitted no liability to Hine Pontiac until termination of the contract with the finance company and full payment of the notes by the makers thereof (Stipulation 13 R. 27). The finance company thus used the "dealer's reserve account" as a contingency fund to absorb its losses on the notes acquired from Hine Pontiac on a nonrecourse basis (Stipulation 13 R. 28). Also, the reserve was subject to being decreased by prepayment of notes of customers prior to the time they were due (Stipulation 13 R. 28).

Hine Pontiac plead and proved that it kept its books on the accrual basis of accounting and also used the reserve method of accounting for bad debts (Stipulation 4 R. 24). It further plead in the alternative that the amounts set up in the "dealer's reserve account" constituted a reasonable

and proper reserve for bad debts (R. 13 and 14). By stipulation it showed that on December 31, 1953, the total outstanding balance of notes was Eight Hundred Sixty-Six Thousand Eight Hundred Sixty-Four Dollars and Sixty-Nine Cents ($866,864.69) and as of December 31, 1954, it had a total outstanding balance of notes of Two Million Four Hundred Twelve Thousand Nine Hundred Nine Dollars and Four Cents ($2,412,909.04). (Stipulation 23 R 30.) It also showed by stipulation that its experience on losses sustained through dealer's reserves was four and nine-tenths per cent (4.9%) in 1953, and three and two hundred thirty-two thousandths per cent (3.232%) in 1954 of the amount of losses as compared to the amount of notes outstanding (Stipulation 24 R. 30).

Also, testimony was introduced to show that four per cent (4%) constituted a reasonable reserve for bad debts (R. 73-74). By simple computation and multiplication of such loss ratio times the amount of notes outstanding it is demonstrated that the amount of reserves held by the finance companies constituted an amount less than the amount of a reasonable reserve for bad debts for Hine Pontiac, so that in any event the amount set up by the finance companies in the "dealer's reserve account" would constitute a reasonable reserve for bad debts for Hine Pontiac. It was also proved that the finance companies themselves do not treat as income any amount placed to an unearned discount account which is what the "dealer's reserve account" is (R. 72-73).

Hine Pontiac paid the deficiencies of Sixteen Thousand Twenty-Seven Dollars and Fifty-Four Cents ($16,027.54) and Twenty-Six Thousand Three Hundred Eighty-One Dollars and Forty-Seven Cents ($26,381.47) for 1953 and 1954 plus interest of Five Thousand Five Hundred Eighty-One Dollars and Ninety-One Cents ($5,581.91), and then filed claims for refund which were denied and the United States District Court entered judgment for Hine Pontiac in the amount of Forty-Two Thousand Four Hundred Nine Dollars and One Cent ($42,409.01) plus assessed interest in the amount of Five Thousand Five Hundred Eighty-One Dollars and Ninety-One Cents ($5,581.91), or the total sum of Forty-Seven Thousand Nine Hundred Ninety Dollars and Ninety-Two Cents ($47,990.92), together with interest, and the United States District Court in holding in favor of Hine Pontiac said:

> "It is the soul and life blood of a tax against the citizen, that the citizen should have received something which justifies the tax."

By stipulation (Appendix A) the Court of Appeals affirmed the United States District Court.

REASONS FOR DENYING THE WRIT

The question in this case is not the same as that presented in COMMISSIONER v. JOHN HANSEN AND SHIRLEY G. HANSEN, NO. 380, THIS TERM, and in COMMISSIONER v. BURL P. GLOVER, NO 381, THIS TERM. The facts are different and neither case contained the issue that the "dealer's reserve account" constituted a reasonable reserve for bad debts.

Furthermore, it is certainly beyond the realm of reason to state that the amount held by the finance company in the "dealer's reserve account" constitutes a right of the taxpayer to receive the same (SPRING CITY FOUNDRY COMPANY v. COMMISSIONER, 292 U. S. 182), when the amount so to be assessed against the taxpayer is subject to the following contingencies and uncertainties:

> (a) The credits to the "dealer's reserve account" are made before any payments have been collected or notes paid to said account, and may never be collected if the purchaser does not pay the same.
>
> (b) Losses of the finance company are chargeable against the account.
>
> (c) Hine Pontiac, the dealer, has no control over the account, and the account remains wholly in the control of the finance company.
>
> (d) Notes which are prepaid by purchasers reduce the "dealer's reserve account."

It should always be remembered and borne in mind as stipulated by the parties that this is one transaction and the car is not sold until the finance company approves the credit of the purchaser. Thus it is one simultaneous transaction and does not constitute a separate transaction of the car being sold to the purchaser and the note being sold to the finance company. These facts are different and when coupled with the proposition involved herein for a reasonable reserve for bad debts constitutes ample reason why the writ of certiorari should be denied and the same

should not be held in abeyance pending the decision in the *Hansen* and *Glover* cases.

Respectfully submitted,

PAUL J. SEDGWICK,
Barr Building,
910 Seventeenth Street, N.W.,
Washington, D. C.,
Attorney of Record for Respondent.

L. W. ANDERSON,
1201 Corrigan Tower,
Dallas, Texas.

By .....

CERTIFICATE OF SERVICE

Respondent, Hine Pontiac, served three copies of Respondent's Brief in Opposition, in accordance with Rule 33, Subsections 1 and 3(b), by depositing copies of the Brief in the United States Post Office at Dallas, Texas, Air Mail, postage-prepaid, addressed to Counsel of Record for Petitioner, J. Lee Rankin, Solicitor General, Department of Justice, Washington 25, D. C.

.....

PAUL J. SEDGWICK,
Barr Building,
910 Seventeenth Street, N. W.,
Washington, D. C.,
Attorney of Record for Respondent.

APPENDIX "A"

STIPULATION OF THE PARTIES FILED:
September 6, 1958

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 17,242

UNITED STATES OF AMERICA,
APPELLANT

V.

HINE PONTIAC,
APPELLEE

ON PETITION FOR REVIEW OF THE DECISION OF
THE UNITED STATES DISTRICT COURT FOR
THE NORTHERN DISTRICT OF TEXAS

STIPULATION

The parties to the above-entitled proceedings, by their counsel of record, hereby stipulate as follows:

1. Whereas one of the issues in this case is whether certain amounts which several finance companies credited to a reserve account in taxpayer's name should be taken into taxpayer's income when so credited where taxpayer was on an accrual basis of accounting; and in the alternative, whether or not the amount retained in such reserve account constitutes a reasonable reserve for bad debts;

2. Whereas in certain respects the first issue was decided by this Court on January 7, 1958, in *Texas Trailercoach, Inc.* v. *Commissioner*, 251 F. 2d 395, and on February 6, 1958, in *West Pontiac, Inc.* v. *Commissioner*, both in favor of the taxpayer;

3. Whereas the parties to this proceeding desire to avoid further expense in connection with the appeal; and the appellant is willing, without conceding the correctness of the appellee's position, that the case be disposed of without briefing and oral argument;

NOW THEREFORE, it is stipulated and agreed by and between the parties, by their counsel of record, that, subject to the approval of the Court, the case may be disposed of without briefing and argument in accordance with the proposed order attached.

/s/ CHARLES K. RICE

CHARLES K. RICE
Attorney for Appellant

/s/ L. W. ANDERSON

L. W. ANDERSON
1201 Corrigan Tower
Dallas 1, Texas
Attorney for Appellee

September 4, 1958

A true copy.
Test: EDWARD W. WADSWORTH
Clerk, U. S. Court of Appeals, Fifth Circuit

By /s/ Gilbert F. Ganushean
Deputy

New Orleans, Louisiana

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Office-Supreme Court, U.S.
FILED
JAN 6 1959
JAMES R. BROWNING, Clerk

No. 561

In the

Supreme Court of the United States

OCTOBER TERM, 1958

UNITED STATES OF AMERICA,

Petitioner,

v.

MODERN OLDS, INC.,

Respondent.

Reply Brief to Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BONNEY, WADE & STUBBLEFIELD,
HERBERT S. BONNEY, JR., and
M. M. WADE,
1133 Fidelity Union Life Building,
Dallas, Texas,
Attorneys for Modern Olds, Inc.

WARLICK LAW, INC.—1207 HORD STREET—DALLAS—RI 1-6711

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